Consultation on a Proposed Update to The Northern Ireland Fuel Security Code

March 2008

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# Introduction

The Northern Ireland Fuel Security Code (the “FSC”) was designated by the Department of Economic Development as at 31st March 1992 as a condition of licences granted under Article 10 of the Electricity (Northern Ireland) Order 1992. The FSC has also been incorporated into conditions of subsequently issued electricity licences and has remained unchanged since its initial designation.

A number of substantial developments have taken place in the electricity industry in Northern Ireland since 1992, and the original provisions of the FSC have become increasingly out of date as such developments have been implemented. Most recently, the implementation of the All-Island Single Electricity Market (SEM) pursuant to The Electricity (Single Wholesale Market) (Northern Ireland) Order 2007 and further changes to implement the EU Directive 2003/54/EC pursuant to the Electricity Regulations (Northern Ireland) 2007 mean that, in the view of the Northern Ireland Authority for Energy Regulation (NIAUR) and the Department of Enterprise, Trade and Investment (“The Department”), it is now appropriate to make changes to bring the FSC up to date, such that it can continue to operate effectively against the background of the prevailing industry framework.

It is acknowledged that a wider-ranging review of fuel security arrangements is also needed in the context of the all-island arrangements[[1]](#footnote-1). Consequently, the scope of the proposed changes put forward for consultation in this document is limited essentially to those mechanistic changes required to make the FSC operable against the current industry framework. It does not seek to change fundamentally any of the principles enshrined within the existing FSC. Nevertheless, because the scope of the industry restructuring changes since 1992 has been considerable, the changes put forward are also relatively substantial in scope.

Processes for carrying out a wider review of longer term security issues across electricity and gas are being progressed by the Department acting in conjunction with the Authority and, in the Republic of Ireland, the Department of Communications, Energy and Natural Resources and the Commission for Energy Regulation. In the meantime, NIAUR and the Department believe that it is appropriate to make interim changes to the FSC put forward in this document to update it such that it is able to fulfil its intended function, if required, in the short-term.

The FSC addresses certain practical issues associated with the making of directions by the Department in relation to fuel security under the Electricity Order. The proposed changes to the FSC put forward in this paper are intended to reflect a minimum change approach required to make the FSC operable against the current industry framework. Whilst the FSC does not, itself, necessarily contemplate the circumstances in which it would have effect, the introduction of the SEM may be expected to have an impact upon when the Department may choose to give directions in relation to fuel security. Furthermore, the revised market arrangements in place following the introduction of the SEM are also likely to have an effect upon the circumstances in which claims for compensation are valid. A detailed consideration of when the FSC may be called into operation and the circumstances in which compensation is valid against the background of the SEM arrangements is outside the scope of this paper. These are issues to be addressed in the context of the consideration of longer term arrangements for fuel security referred to above.

Comments, representations and objections are invited on any of the proposals set out in this document including the proposed changes to the FSC set out in Annex 1 and the process by which NIAUR proposes to amend the FSC pursuant to paragraph 2 of the FSC, as further described in section 4.

# Background

## Legislation

Articles 37 and 38 of the Electricity Order[[2]](#footnote-2) give the Department powers to give certain directions in relation to fuel security. In summary:

* Article 37 empowers the Department to give directions to power station operators as to:
* arrangements relating to amounts of fuel stocks at or near the relevant power station;
* the use by power stations of particular fuel stocks;
* the manner of operation of the power station (or omission to operate).
* Article 38 empowers the Department to give directions:
* requiring a transmission licence holder to provide information and advice required in connection with the exercise of the Department Article 37 functions;
* concerning the conduct by transmission licence holders of their regulated activities when a direction as to the operation of a power station is in force.

The Northern Ireland Fuel Security Code (“FSC”) is a code to which all electricity licence holders in Northern Ireland become party under their licences. It was drafted in 1992 and has not subsequently been amended. When read in conjunction with certain provisions of Northern Ireland electricity licences, it contains provisions giving rights and obligations to licence holders in relation to the exercise by the Department of its Article 37/38 powers. These provisions are tied in directly to such powers (and in particular to the exercise by the Department of its power to direct power station operators as to the manner of operation of a power station – the period during which such a direction is in force being defined as a “Security Period”).

## All-Island Impact and the Single Electricity Market

The principal legislation used to introduce the Single Electricity Market in Northern Ireland was the Electricity (Single Wholesale Market) (Northern Ireland) Order 2007 (the “SEM Order”).

This legislation made changes to the objectives of both the Department and the Authority in relation to matters which are likely to materially affect the SEM. In particular, the principal objective of both the Department and the Authority (and the newly established SEM Committee) in relation to such matters is to:

“.. protect the interests of consumers of electricity in Northern Ireland and Ireland supplied by authorised persons, wherever appropriate by promoting effective competition between persons engaged in, or in commercial activities connected with, the sale or purchase of electricity through the SEM.”

It is likely that any exercise by the Department of its powers under Articles 37 or 38 of the Electricity Order will have a material affect on the SEM. As a consequence, in exercising (or not exercising) these powers, the Department would need to have regard to its principal duties as amended by the SEM Order.

Such matters will need to be borne in mind when progressing the wider review of fuel security issues in both Northern Ireland and the Republic of Ireland referred to in Section 1. However, they are outside the direct scope of the changes to the FSC proposed in this paper. In the meantime, a discussion of how the Authority expects the revised FSC put forward in this paper to operate against the background of the Single Electricity Market is set out in sections 3.3 of this paper, whilst recognising that a decision as to the issuing of directions under Articles 37 and 38 is a matter for the Department’s discretion, not the Authority’s.

Irish electricity legislation contains no equivalent or similar provisions to Articles 37 and 38, or the powers provided for in them. Accordingly, there is no equivalent document in Ireland to the FSC. However, in the Republic of Ireland, Statutory Instrument No. 60 of 2005 states that “*it shall be the duty of the Commission to monitor security of supply of electricity*”. Furthermore, Part 10 (5), Regulation 28 of the same Statutory Instrument provides that “*the Commission shall take such measures as it considers necessary to protect security of supply*”. Against this background, in October 2007, the Commission for Energy Regulation published a summary report highlighting the main recommendations of the Task Force on Emergency Procedures, with regard to coordination between the gas and electricity systems[[3]](#footnote-3) in the Republic of Ireland. Further to this report, the Commission for Energy Regulation has also recently published a draft decision on the Secondary Fuelling Obligations on Licensed Generation Capacity[[4]](#footnote-4) in which the Commission identifies that in the longer term a common approach in dealing with security of supply events will likely be developed in the SEM market.

## Existing FSC provisions

In summary, the existing FSC contains provisions:

* for the creation of a Fuel Supplies Committee comprising industry representatives and chaired by NIE plc;
* for the provision by licence holders of information before or during a Security Period;
* relating to planning for emergencies;
* for conflicting provisions of the Grid Code to be overridden by directions under Articles 37 and 38;
* concerning the operation of transmission and distribution systems during a Security Period;
* for the clarification of directions given by the Department under Article 37;
* for continued compliance with long-term PPAs during a Security Period; and
* for the recovery by licence holders of certain costs (or, in the case of generators, profit reductions) incurred in connection with a Security Period.

The majority of the FSC’s provisions deal with cost/profit recovery. Essentially, these provisions are structured as follows:

* Generators who incur costs or reduced profits in connection with a Security Period can (subject to checks and balances) recover these from the Power Procurement Business (“PPB”).
* Under the PSO charge restriction, the PPB can recover payments made to generators under the above provisions and its own allowed security costs in connection with Security Periods through PSO charges.
* Under the transmission and distribution charge restriction in NIE plc’s licence to participate in transmission, NIE T&D can recover its allowed security costs in connection with Security Periods through its transmission and distribution charges.

It should be noted that the existing FSC arrangements are implicitly structured to apply to an industry framework which no longer applies in Northern Ireland. For example, the arrangements do not explicitly apply equally to all affected licence holders (for example not all suppliers and generators are explicitly dealt with under the Code). Furthermore, the existing FSC arrangements afford a greater role to PPB/Power Procurement Manager than is appropriate following the implementation of the SEM/Directive changes in 2007.

# Proposed Changes

## General

The changes proposed to the FSC are intended to cater for a number of structural changes in the industry since the initial introduction of the FSC in 1992. These include for example the introduction of the single wholesale electricity trading arrangements enshrined within the Trading and Settlement Code; separate licensing of SONI as system operator and SEM Operator; the new role of NIE T&D as collector of the PSO; and revised role of the PPB activity under NIE Energy’s supply licence.

Section 3.2 below sets out a discussion of the proposed principal changes to the FSC as a consequence of particular industry restructuring changes. Section 3.3 then goes on to describe how the Authority expects that the updated FSC might operate against the background of the Single Electricity Market, whilst recognising that a decision as to the issuing of directions under Articles 37 and 38 is a matter for the Department’s discretion, not the Authority’s.

## Discussion of Proposed Principal Changes

### Changes to reflect the all-island nature of the Department’s and the Authority’s duties in respect of security of supply and overall consumer welfare

Even though the changes put forward in this paper do not envisage an extensive structure for co-ordination of actions and a sharing of risk cross border in respect of a Security Period[[5]](#footnote-5), actions taken during such a period are likely to reflect the exercise of the Department’s and the Authority’s SEM duties rather than their domestic duties. The proposed FSC amendments reflect this. Such changes will include an amendment to the FSC modification process to ensure that any decisions as to whether to modify taken by the Department or the Authority are consistent with either the SEM duties or the Energy Order[[6]](#footnote-6) duties, whichever are applicable, rather than in accordance with purely domestic considerations.

These matters are reflected in the proposed changes to Part 2 of the FSC.

### Changes to reflect the restructuring of NIE to implement the SEM and the IME2 Directive

Extensive changes are proposed to the FSC to reflect the transfer of the bulk of the TSO[[7]](#footnote-7) function to SONI and to SONI’s separate licensing and the transfer of the PPB and supply activities to NIE Energy and NIE Energy’s separate licensing.

The specific changes proposed include:

* Amendment to the objects and purpose of the code (Part 1 section 3.03) to generally update this section to reflect the new arrangements.
* Amendment to the right within the modification rules for “the Transmission Licensee” to propose changes to the FSC so that it applies to the TO (as administrator of the PSO Charge) (Part 2 paragraph 2.01E).
* Amendment to the obligations imposed on the Transmission Licensee in Part 3 section 1 in relation to planning for a Security Period so that these apply to the TSO and imposition of obligations co-operate with the TSO on the TO.
* Amendment to the cost recovery provisions of Parts 3, 5 and 6, including amendment to the provisions imposing obligations on the “Transmission Licensee” so as to impose such obligations on the TSO and TO in accordance with the arrangements described above.
* Amendment to the provisions for the establishment and chairing of the FSC Committee, in particular, providing for the TSO to be the Committee Chairman.
* Amendment to Part 4 in relation to the operation of the Transmission System to replace references to the “Transmission Licensee” with references to the TSO.
* Amendment to Schedule 1 to reflect that the relevant information would be requested by the TSO rather than the “Transmission Licensee”.

### Changes to reflect the introduction of the pooling arrangements

The introduction of the pooling arrangements and the TSC also needs to be reflected in the FSC. Proposed changes to reflect this include:

* Amendments to Part 2 section 4 and Part 4 sections 2 and 3 so that the FSC and any direction will override any provision of the TSC as well as any provision of a PPA.
* Amendment to the provisions relating to the FSC Committee to reflect the greater role of generators and the lesser role of the PPB in a Security Period to that prior to introduction of the pool (Part 3 section 4).
* Amendment to Part 5 section 1 to require licensees to comply with the TSC during a Security Period (except in circumstances where its terms are overridden by a direction or the FSC) in addition to the current obligation on the PPA generators to comply with the PPAs in such circumstances.
* Amendments to Parts 3, 5 and 6 to reflect the more limited role of the PPB and the PPAs in relation to cost recovery, and to respect legacy arrangements under the privatisation settlement in relation to profit recovery of generation units which are the subject of PPAs.

### Changes to reflect the introduction of supply competition

The existing FSC assumes that NIE operates as a PES and other suppliers are only able to operate on a second tier basis. Extensive changes are required to the FSC to reflect the introduction of supply competition and removal of the PES category. Such changes are proposed to include:

* Amendment to the modification rules (Part 2 section 2) to remove references to the PES and second tier suppliers and to extend the role played by suppliers in the modification process.
* Amendments to the cost recovery provisions in Parts 3, 5 and 6 to remove the reference to the PES, to enable all suppliers to recover uneconomic costs and to impose obligations on all suppliers to assist in the cost recovery arrangements.
* Amendments to the provisions relating to the FSC Committee to give all suppliers a role in its proceedings.
* Inclusion of relevant proforma statements and reports set out in the Schedules required in respect of cost recovery arrangements for suppliers.

### Changes to reflect the role of the MO

Provision also needs to be made in the FSC to take account of the role of the SEM MO in any Security Period. As well as changes referred to above, these are proposed to include:

* Amendments to the cost recovery provisions in Parts 3, 5 and 6 to enable the MO to recover additional costs it might incur in a Security Period.
* Inclusion of relevant proforma statements and reports set out in the Schedules required in respect of cost recovery arrangements for the MO.

### Miscellaneous changes

A number of additional updates to the FSC are also proposed to reflect other changes since 1992. These include:

* Amending references to “the Director” to references to the Authority.
* Updating the reference to “Licensees” so that it covers all new classes of NI licensee.
* Amending Parts 3 to 6 to allow Moyle Interconnector Ltd to recover its additional costs in relation to a Security Period and to impose certain obligations upon it in relation to any directions given to it under Article 38.

## Operation of the Updated FSC within the Context of the SEM

In putting forward the changes, NIAUR has given some consideration to the interaction with other industry documents, principally the Grid Code and the Trading and Settlement Code (TSC). NIAUR is of the view that if the FSC changes proposed in this document are adopted, it would not be necessary for any additional changes to be made to the TSC or Grid Code in order for the FSC arrangements to work in a reasonable manner.

In assessing whether or not this is reasonable it is, to a certain degree, necessary to speculate as to the circumstances in which the Department might exercise its powers under Articles 37 or 38 and if so, in what manner they would do so. Whilst NIAUR is of the view that such matters should be considered in more detail as part of a wider review of security issues, the SEM arrangements are inherently more stable to substantial external shocks than other market mechanisms, principally because the price submissions from generators are based on the requirements of the bidding principles. Hence, it might be assumed that the SEM market mechanisms might operate reasonably without additional intervention in a variety of more onerous circumstances. This is reflected in the fact that the Trading and Settlement Code does not itself provide for a wider range of scenarios under which market suspension and/or alternative administrative arrangements are put into effect. Views are specifically invited upon the Authority’s initial view that no changes are required to other documents in order to support the proposed changes to the FSC included in Annex 1.

## Cost Recovery/Maintenance of Profitability

One significant element of the FSC proposals put forward in this document is whether the principles behind the calculation of compensation in relation to a Security Period are related to cost recovery or retention of profitability.

The proposed FSC changes put forward by NIAUR in Annex 1 of this document are intended to provide for compensation based on (i) cost recovery for licence holders other than PPB generators and (ii) retention of profitability for PPB generators. The reasons for this proposed approach is that it essentially constitutes a “no change” solution for PPB generators and those incurring central costs (PPB, the transmission system owner/operator, etc.). For other parties that are for the first time explicitly dealt with under the FSC (i.e. other generators and suppliers) the arrangements constitute what NIAUR views as the only pragmatic approach to this matter.

Insofar as non-PPB generators and suppliers are concerned, there may be an argument that they should also be treated in the same manner as PPB generators, i.e. that the FSC should act so as to maintain their level of profitability in a security period in the same way that it does for PPB generators. However, NIAUR does not believe that this approach is either practicable or consistent with similar arrangements established elsewhere. From a practicality perspective, it would be very difficult to construct a counterfactual scenario against which to measure expected profits of the relevant licensees and hence that any calculation and audit of payments or charges would be very complex. Furthermore, NIAUR is of the view that as a general principle, it is most appropriate for costs to be remunerated in such circumstances rather than profits. Such principles are, for example, consistent with the arrangements in place in the GB Fuel Security Code and the existing arrangements in the NI FSC other than in relation to PPB generators.

# Proposed Process for Amendment

This section describes the process by which it is proposed that the updates to the FSC set out in this document will be taken forward.

## FSC Modification Provisions

Clause 2 of the FSC provides (inter alia) for the Code to be modified by the Director[[8]](#footnote-8) with the consent of the Department, after consultation with all Licence Holders, where the Director considers, having regard in addition to his duties under the Energy Order to:

* any representations or objections which are duly made and not withdrawn,
* to the periods of time within which the Director considers it desirable to introduce such modifications and;
* to the availability of the powers of modification contained in Articles 14 to 18 of the Order

that such modifications are in the best interests of the electricity industry as a whole.

Before making any modifications in accordance with the above, the Director must give each Licence Holder, in accordance with paragraph 2.02 of Part 2, a notice stating in such detail as he considers appropriate in the circumstances:

1. the modifications proposed;
2. the reasons why the modifications are considered to be in the best interests of the electricity industry in Northern Ireland as a whole and the reasons why any powers of modification available pursuant to Articles 14 to 18 of the Order are not being utilised; and

also specifying the period of time which he considers appropriate in the circumstances within which representations of objections with respect to the propose modifications may be made.

## Proposed Approach and Reasons

NIAUR proposes that the FSC be amended as set out in Annex 1 of this document in accordance with the arrangements under Article 11(5) of the Order and Part 2.01(C)of the FSC.

The principal reasons why NIAUR proposes not to adopt the change management processes set out in Articles 14 to 18 of the Order are that:

* the proposed changes to the FSC do not fundamentally change the principles behind the application of the FSC but instead serve simply to update the FSC in light of industry changes since 1992. Consequently, no substantive changes to fundamental principles are being put forward;
* Given that the current FSC is substantially out of date and that it may, in principle, be necessary to rely upon the FSC arrangements at any time, NIAUR is of the view that it is appropriate to progress the changes in the most expeditious manner available. NIAUR is of the view that this is most likely to be through the Article 11(5) change management route rather than through Articles 14 to18;
* A wider review of security issues is being progressed to review how the FSC and associated arrangements should apply more generally. Any more fundamental policy issues can subsequently be addressed as part of this wider process.

NIAUR is of the view that the proposed modifications put forward in this document are in the best interests of the electricity industry in Northern Ireland as a whole for the following reasons:

* The proposed changes will have the effect of bringing the existing FSC quickly up to date. Hence sensible FSC arrangements can be put in place relatively soon which can support operation in any security period without substantially affecting the principles enshrined in the existing FSC and without prejudicing a wider review of security arrangements.
* The changes provide for equivalent licensees to be treated equally (although it is recognised that the existing particular treatment of PPB generators under the current FSC has been retained). This means that new entrant generators and suppliers are now more explicitly covered in an equal manner by the FSC arrangements.
* The arrangements provide clarity and certainty to those involved in central functions (SONI, NIE T&D, PPB) in light of the recent electricity industry reforms. The revised arrangements also reflect revised structural responsibilities, independence arrangements, access to information etc. which are implicit in the new arrangements.

NIAUR considers it desirable to introduce the modifications set out in this paper in June/July 2008. This timing is intended to strike a balance between giving licence holders and other affected parties sufficient time to make representations and raise any objections to the proposed changes and the process by which it is proposed they should be effected and the need expeditiously to establish more robust FSC arrangements against the background of the new market arrangements. In summary NIAUR propose the following provisional timetable:

* Responses to this consultation (representations and objections) to be received by Mid May 2008
* Comments/objections taken into account and any necessary revisions to the proposed changes incorporated into revised proposals. NIAUR may also enter into a dialogue with those who have raised objections in order to seek to resolve them.
* If necessary, at this stage a further consultation may be undertaken if, in NIAUR’s view the nature of the changes suggested to be made are sufficiently substantial to warrant this. In this case, there may be a delay to implementing the FSC modifications in June/July 08. Otherwise, NIAUR would finalise the drafting changes and seek the approval of the Department to the changes being put forward.
* It is hoped that Departmental consent for the proposed changes would be given in the second half of June 2008. Again precise timing depends on the nature/scope of responses to this consultation.
* Formal modification of the FSC would then take place towards the end June early July 2008.

# Comments Invited

Comments, representations and objections are invited on any of the proposals set out in this document including the proposed changes to the FSC set out in Annex 1 and the process by which NIAUR proposes to amend the FSC as described in section 4 above.

These should be sent, **by 17:00 on 16th May 2008** preferably in electronic format to:

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Respondents should indicate clearly if any part of their response should be treated confidentially.

Annex 1: FSC marked with Proposed Changes

1. See section 2.2 for a further discussion of the all-island impact on the FSC. [↑](#footnote-ref-1)
2. The Electricity (Northern Ireland) Order 1992 as amended. [↑](#footnote-ref-2)
3. See: http://www.cer.ie/en/electricity-security-of-supply-current-consultations.aspx?article=3a0172c7-ec4c-4863-96c4-6320975f9556. [↑](#footnote-ref-3)
4. See: http://www.cer.ie/en/electricity-security-of-supply-current-consultations.aspx?article=2a1a707c-9375-4b01-bb0c-827e38a01b1d. [↑](#footnote-ref-4)
5. Instead, such matters are to be progressed under the longer-term review referred to in section 1. [↑](#footnote-ref-5)
6. The Energy (NI) Order 2003 [↑](#footnote-ref-6)
7. As part of the implementation of the SEM, the majority of the transmission system operator (TSO) functions were explicitly transferred to SONI who were granted a new licence to participate in transmission, pending subsequent divestment of SONI by NIE. Prior to the introduction of the SEM, SONI carried out a number of TSO related activities under the aegis of NIE’s transmission licence. [↑](#footnote-ref-7)
8. In this context, the Director has been succeeded by the Northern Ireland Authority for Utility Regulation (NIAUR) [↑](#footnote-ref-8)